06 Adapting Total Rewards to Industry Factors: The Case of the Oil and Gas Industry
By Steve Werner, Ph.D., University of Houston

16 Is Black-Scholes Always the Right Option?
By Blair Jones, CCP, CBP, CECP, John Borneman, CECP, and Jason Brooks, Semler Brossy Consulting Group

25 A People-First, Bottom-Up Approach to M&A Deal Value
By Jeff Cox and Gregg Passin, Mercer

30 Executive Compensation: Midmarket Companies Are ‘Fast Followers’ of Large Companies
By James F. Reda, Arthur J. Gallagher & Co.

36 Global Trends in Pay: The Old Normal?
By Marco Poggetti and Carole Hathaway, Willis Towers Watson

42 Published Research in Total Rewards
Mission

WorldatWork Journal strives to:

❚ Advance the theory, knowledge and practice of total rewards management.
❚ Contribute to business-strategy development that leads to superior organizational performance.
❚ Provide an outlet for scholarly total rewards writing and research.

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Adapting Total Rewards to Industry Factors: The Case of the Oil and Gas Industry
By Steve Werner, Ph.D., University of Houston

Total rewards professionals should not rely on a one-size-fits-all approach to reward strategies, but instead should adapt them to their dynamic external business environment, which is usually driven by industry-specific issues. This article uses the oil and gas industry to illustrate how industry-specific factors can substantially affect total rewards professionals’ strategic decisions regarding performance management and total rewards.

Is Black-Scholes Always the Right Option?
By Blair Jones, CCP, CBP, CECP, John Borneman, CECP, and Jason Brooks, Semler Brossy Consulting Group

When a company has a materially different Black-Scholes value from the competitive market, it is important to understand what is driving the differences to ensure this disconnect is appropriate. In most cases, using Black-Scholes to calibrate awards remains a reasonable approach, but at extremes, Black-Scholes may not always be the right option.

A People-First, Bottom-Up Approach to M&A Deal Value
By Jeff Cox and Gregg Passin, Mercer

As merger and acquisition (M&A) activity continues its global race toward value, thriving organizations cannot risk ignoring the right strategies for talent retention. Research shows successful buyers have elevated their retention strategies from an art to a repeatable science. The results are tangible and clear — increased productivity and engagement, owner-like behaviors from retained employees and accountability throughout the organization.
Executive Compensation: Midmarket Companies Are ‘Fast Followers’ of Large Companies
By James F. Reda, Arthur J. Gallagher & Co.

Midmarket companies are catching up to large companies when it comes to executive compensation levels and design. Although large companies continue to pay significantly more than midmarket companies, a comparatively higher level of pay growth among the midmarket reflects a catch-up process. What’s more, the structure of executive compensation plans among many midmarket companies has started to mirror that of top-performing companies.

Global Trends in Pay: The Old Normal?
By Marco Poggetti and Carole Hathaway, Willis Towers Watson

With several years of low inflation, companies are starting to focus on providing meaningful performance-based or promotion pay increases. This study examines how increased inflationary pressures will likely affect salary budgeting trends in various global markets.

Published Research in Total Rewards
Adapting Total Rewards to Industry Factors: The Case of the Oil and Gas Industry

In the past few decades, the role of total rewards professionals (as well as all HR management professionals) has become more strategic, (Jackson, Schuler, and Jiang 2014; Wright and Ulrich 2017). Strategic thinking is now seen as one of the most important skills in differentiating top performing total rewards professionals from average performers (WorldatWork 2012). This change reflects a greater acceptance that organizations need to think strategically when designing their performance management and rewards systems to optimize the value of their human capital. Strategic thinking means that actions and efforts are focused on practices that will help the company achieve an advantage over its competitors that is sustainable in the long term (Hitt, Ireland, and Hoskisson 2015).

A key aspect of the strategic view is that businesses must formulate and implement strategies and the resulting practices, policies and procedures that adapt to their external business environment. That is, decision makers must consider the company’s external environment, including the legal and political landscape, the economic landscape, the technological landscape,
sociocultural and demographic factors and global conditions in strategic decisions (Jackson, Schuler, and Werner 2017). All of these factors can create opportunities and threats for organizations. To be successful, businesses must not only understand their environment, but must also anticipate changes in the business environment and be proactive in adapting to those changes.

Different industries have substantially different business environments. Many environmental factors, such as available technologies, unemployment rates and labor markets, differ across industries. And factors that don’t differ across industries, such as the interest rates or many laws, affect different industries in different ways. For example, an increase in the minimum wage would have a substantial impact on the labor costs of industries with many low-paid workers, such as retail, but would have little impact on other industries. Because environmental factors vary among industries, total rewards professionals who think strategically need to consider their industry in all key total rewards decisions. That is, total rewards professionals should not rely on a one-size-fits-all approach to reward strategies, but instead should adapt them to their dynamic external business environment, which is usually driven by industry-specific issues. Yet surprisingly, very few articles, academic or practitioner-oriented, focus on industry-specific issues.

The purpose of this article is to encourage total rewards professionals to consider industry factors in their strategic thinking, using the oil and gas industry to illustrate how this can be achieved. It begins by showing some important differences between the oil and gas industry and most other industries. It then shows these differences can substantially affect key strategic decisions regarding performance management and total rewards.

**THE OIL AND GAS INDUSTRY**

Carefully examining the differences among industries can help identify factors in the business environment that should be considered in strategic decision making. Industry analyses can be helped by getting data from a number of different sources including industry associations, government sources such as the Bureau of Labor Statistics (www.bls.gov) and the Department of Labor (www.dol.gov), and professional analyst companies such as D&B Hoovers (www.hoovers.com/industry-analysis.html), IBISWorld (www.ibisworld.com), the Financial Times (https://markets.ft.com/data/) and Mintel (https://store.mintel.com/mintel-market-reports/). A thoughtful industry analysis will help identify how a particular industry differs from most others.

The oil and gas industry depends heavily on natural resources as well as capital resources. Nevertheless, human resources are still critical for success. The research is clear: How employees are compensated and managed affects the bottom line of the organization as well as the productivity and well-being of employees themselves (Huselid 1995). However, because of the distinct differences of the oil and gas industry from other industries, the total rewards and performance management should differ. The article next looks at the distinct differences between the
oil and gas industry and other industries and then shows how these differences affect the strategic total rewards and performance management decisions. It identifies at least nine important ways in which the oil and gas industry differs from most other industries (Werner, Inkpen, and Moffett 2016). These differences are described in Exhibit 1.

To illustrate the effects of industry on strategic total rewards decisions, the article examines the first two differences and shows how they affect key aspects of performance management and total rewards. By understanding industry differences and adapting to them, total rewards professionals can become much more effective.

THE IMPORTANCE OF HEALTH AND SAFETY

According to the U.S. Occupational Safety and Health Administration (OSHA), there are many safety hazards across the oil and gas industry. These include issues of personal safety, process safety, security and illnesses. Hazards in the well-drilling and servicing sector include: being caught between spinning chains and pipe; being struck by various objects such as pipe, chain, whipping hose, tool, and debris dropped from elevated locations; being injured by fires and explosions from well blowouts, releases of gas and aboveground detonation of perforating guns. Rigs can collapse, people can fall from elevated areas and poisonous gases, such as hydrogen sulfide (H₂S), can be released.

Because of the prevalence of hazards, most major oil and gas companies have insisted that the safety of the workforce and their communities is their No. 1 priority. Safety is not only critical in protecting employees and customers, but also in securing oil rights. In the global oil and gas industry — where companies compete for the rights of exploring, developing and operating in other countries — a company’s health, safety and environment (HSE) record and reputation are key to its ability to secure rights to oil and gas. Further, large safety failures, as with BP and the Deepwater Horizon disaster, put the survival of the entire company in jeopardy.

Health and Safety Through Performance Management

Achieving high levels of safety performance through performance management is, theoretically at least, very straightforward. It entails making safety a critical aspect of performance. Doing so involves:

1 | Setting goals for safety performance
2 | Measuring safety performance
3 | Providing feedback on safety performance
4 | Tying meaningful rewards to it.

To maximize effectiveness, safety performance systems should be monitored and evaluated and adjustments should be made when necessary. Safety performance improves when coupled with goal setting. Safety goals should be challenging, but perceived to be obtainable and specific. After measuring safety performance,
EXHIBIT 1 Differentiating Characteristics of the Oil and Gas Industry

1 | The importance of health and safety.  
The number of hazards and their severity set the oil and gas industry apart from others. These hazards range from the danger of falling objects on a drilling rig to a potential explosion at a refinery to malaria threats in sub-Saharan Africa. Many of the products or raw materials used in the industry are volatile, toxic and environmentally sensitive. Security hazards are substantial because much of the work occurs in remote locations.

2 | The unique workforce.  
Compared to most other industries, the workforce of the oil and gas industry has numerous unconventional characteristics. One important distinction is the prevalence of contractors. Another is the frequent use of rotators (employees who regularly commute to a work site on a fixed schedule, such as 28 days on and 28 days off). Other differences include an aging male-dominant workforce, very difficult working conditions and an impending skills gap.

3 | The importance of project management.  
Unlike most other industries, almost all aspects of the oil and gas industry include projects as an important component. The most prevalent projects in the oil and gas industry are the construction and development of facilities. Examples include onshore and offshore oil and gas production facilities, storage facilities, LNG liquefaction facilities, pipelines, refineries, terminals and petrochemical plants.

4 | The level of government involvement.  
Although the government is involved in all industries to a certain extent, in the oil and gas industry the government is deeply involved in nearly every facet. In almost all countries (not the United States), the government owns all the oil and gas resources, even those below privately held land. Governments fully or partially own many of the largest oil and gas companies around the world. Governments regulate almost every aspect of the business, including health, safety and the environment (HSE), drilling, pricing and labor.

5 | The global nature of oil and gas.  
The oil and gas industry is one of the most global industries in the world. Its products are used in every country and most countries are producers. The major companies in the oil and gas industry operate in dozens of countries and have employees of dozens of nationalities. Further, partnerships, such as joint ventures that are common in oil and gas projects, frequently span many different countries.

6 | The proactiveness of stakeholders.  
There are not many industries that possess the complexity of stakeholder interests as that of the global oil and gas industry. The visibility and scrutiny of businesses operating in the oil and gas sector is somewhat due to the negative reputation of the industry in the past. Oil and gas companies get harshly criticized for all perceived negative outcomes. The industry’s broad reach allows it to touch virtually every person on the planet as a customer or community member. Thus, everyone on Earth is a stakeholder of companies in the oil and gas industry.

7 | Price unpredictability.  
Just in the past decade, the price of a gallon of crude oil has ranged from more than $145 per barrel (July 2008) to less than $30 per barrel (February 2016). Imagine if the price of the products your organization sells dropped 80%. How would that impact your company and how you do business? This possibility is always a reality for oil and gas companies. The uncertainty in the economic value of the products the oil and gas companies produce is something businesses must deal with and consider in all strategic decisions.
regular feedback should inform employees how they are doing relative to achieving the goals.

Feedback has been shown to be critically important in helping achieve high levels of safety performance and appears to have a strong effect when it goes beyond the feedback of the annual performance evaluation. Feedback should be regular, such as weekly updates on safety performance, and immediate when safety violations are discovered. Studies have shown that training alone has little effect or only slightly improves safety performance. However, training with regular feedback after training greatly improves safety performance and helps maintain it (Ray, Bishop, and Wang 1997; Laitinen and Ruohomaki 1996).

Finally, to maximize the effects of feedback and goal setting, tying rewards to safety performance will further help motivate employees to achieve safety goals and maximize safety performance.

Health and Safety Through Total Rewards

Rewards are a powerful motivator to influence safety-related behavior. However, rewards can have positive or negative effects. You tend to get what you reward. If you reward big bonuses for safe behavior, you get safe behavior. If you reward productivity, you get productivity, perhaps at the expense of safe behaviors. Thus, the aspect of compensation that appears to have the greatest influence on safety performance is the use of performance-based rewards.

**Performance-based rewards.** Performance-based rewards can have a strong impact on safety performance by using safety bonuses, bonuses tied to non-safety measures and recognition programs.

Bonuses based on both individual and group measures of safety performance have been shown to lead to better safety outcomes, such as a reduction in employee injuries (Lauver 2007). Individual measures seem to be less effective than group measures. Bonuses have a powerful effect, so the use of safety bonuses must be done with care. The safety performance measure must be carefully chosen because employees will focus specifically on the measure. So if a bonus is based on the number of reported incidents, then employees will be less likely to report incidents. Bonuses can also cause unintended consequences. Employees may find loopholes, game the system or just ignore other aspects of performance that don’t lead to bonuses. Safety bonuses must be carefully designed and after implementation, carefully monitored, evaluated and adjusted to properly focus their motivational effects and reduce possible unintended consequences.

Safety performance will be reduced when businesses offer large bonuses based on productivity, quantity, profits, sales or any other measures that could compromise safety. Safety-oriented behaviors, such as taking greater precautions, more training and stopping machinery, increase cost and slow productivity in the short term. Although it is less safe, driving faster usually gets you there quicker.
Therefore, the size of bonuses for measures that could hurt safety performance should be limited.

Recognition awards can also affect safety performance and they don’t have a lot of the downsides that come with safety bonuses. Recognition awards may not be quite as motivational as big cash bonuses, so employees are not as likely to under-report accidents or focus exclusively on safety for a plaque, certificate or T-shirt as they would for a large cash bonus. Recognition awards have other benefits, such as signaling the importance of safety. Plus, they are low-cost and yet still quite motivational (Li et al. 2016).

**Benefits.** Benefits can indirectly affect safety performance in numerous ways. Wellness programs, employee assistance programs and health insurance can all affect employee health and well-being, which are indirectly related to safety. Wellness programs can motivate healthier and safer behaviors such as not smoking. Similarly, assistance programs can help employees deal with substance dependence issues, legal problems, financial problems and mental health issues, all which could affect employees’ safety as well as health and general well-being. Health insurance is an important benefit that can help employees maintain or regain good health, particularly if they are international assignees who without it would have to face suboptimal levels of health care.

**THE UNIQUE WORKFORCE OF THE OIL AND GAS INDUSTRY**

The workforce of the oil and gas industry has several features that are unconventional compared to most other industries. Although some of these features also apply to other industries, together they result in a workforce that is very different than that of most other industries. The features include:

- **The prevalence of contractors.** Contract workers can cover a broad range of employment relationships, including short-term workers, part-time workers, agency workers and day laborers.
- **The use of rotators.** Rotational employees are workers who regularly commute to a work site on a fixed schedule, such as 28 days on and 28 days off.
- **An aging workforce.** Some surveys show that the average age of workers in the oil and gas industry may be as high as 48 to 50 years old.
- **A male-dominated workforce.** Although estimates vary based on job, sector, employer and country, most estimates suggest that the industry is composed of only around 20% females.
- **Difficult work conditions.** Many workers are in remote locations susceptible to nature’s harshest elements.
- **An impending skills gap.** Almost all senior HR managers in large international gas companies see a shortage of talent as one of the top concerns facing the industry (Pyron 2008).

Although these factors vary somewhat by country, they are relatively common across countries.
Adapting Performance Management to the Unique Workforce

The unique workforce of the oil and gas industry has numerous implications for performance management. These include the performance measure, which will drive performance goals, and who conducts the performance evaluation.

Measuring performance. Workforce characteristics can have an impact on the fundamental question: “What is performance?” For example, in industries where there is a skills shortage, addressing long-term staffing deficiencies should be part of the performance criteria of every manager. Specific questions that managers need to address in these situations include: “Is there a succession plan in place?” and “Are managers sending their subordinates to the appropriate training?”

The male-dominated aspect of the oil and gas industry indicates a need for better gender balance. Thus, managers should be evaluated on their progress toward increasing women in their ranks and how proactive they are in preventing gender and sexual harassment. Objective measures of this aspect of performance could include:

- Percentage of female new hires
- Percentage increase in female employees
- Percentage of women in the applicant pool of workers who have taken gender and sexual harassment training courses.

When outcomes are not as good as hoped through no fault of the manager, subjective measures that assess the manager’s efforts in these areas should also be considered.

The performance measures may also be affected by the prevalence of contractors. Depending on the type of contractor, performance is frequently specified in the contract. In such cases, contract-specified performance should be carefully measured. Subsequent contracts should take into account things learned with respect to measuring performance in the previous contract. Examples include:

- Were there any aspects of performance that were not specified and, therefore, not properly completed?
- Were there problems with contractor safety performance?
- Were there problems with the handover to the owner’s operations team?

Evaluating and revising performance standards of contractors by considering issues such as these will help improve contractor performance.

Who is involved in performance evaluation? The format and procedures of performance evaluation should be adapted to contractors compared to regular employees. This is because with contractors, the nature of the relationship is specifically defined legally through the contract. Performance, when defined through the terms of a contract, should be evaluated in a formal, clearly specified framework. Thus with contractors, a greater reliance on the legal and HR departments may be necessary.

The use of rotators may also have some effect on who is involved in the performance evaluation. Although supervisors are generally the best source for
evaluating and overseeing the performance of employees, supervisors may be a continent away for rotators in remote locations. In such cases, there may be a need for greater reliance on feedback from co-workers or nonsupervisory managers who are working closely with the rotator.

Adapting Total Rewards to the Unique Workforce

Many of the different features of the unconventional workforce of the oil and gas industry have important implications for total rewards. Some examples:

- The talent gap makes compensation more important because it can be used to attract and retain employees with critical skills.
- The aging workforce and male domination make targeting different groups through different benefits more important.
- The use of contractors and rotators also changes some important aspects of compensation.

Let's look at how the unique characteristics of the workforce in the oil and gas industry can affect strategic decisions regarding pay level, performance-based pay and benefits.

**Pay level.** Pay level has important implications for the talent shortage. Pay level is important to people and affects many of their actions (although this is frequently denied by survey respondents). So, it is not surprising, given the talent gap in jobs such as petroleum engineer, that companies are paying high wages to attract new graduates and retain talent in key jobs. Pay level is also related to the prevalence of contractors. The pay level of contractors relative to permanent employees depends on two factors. The first factor is the type of contractor. Pay for temporary employees tends to be less than for permanent employees. The reasons for this include: they lack seniority pay in their pay scales; they are more likely to have less skilled jobs; and they are generally not unionized (Werner, Inkpen, and Moffett 2016). The second factor is the country and its corresponding pay laws and unionization levels. For example, pay level seems to be the same for contractors and company workers in Ecuador and Australia but higher for company workers in Canada and Norway (Werner, Inkpen, and Moffett 2016).

**Performance-based pay.** Because the workforce composition has implications for performance measures (as discussed earlier), it has implications for the measures tied to performance-based pay. Providing bonuses tied to efforts to overcome the talent gap or for achieving a greater gender balance will help motivate managers to work toward those outcomes. Bonuses may also be a factor in attracting workers relative to the talent shortage. Signing bonuses (with a minimum stay requirement) and returner bonuses for retired employees or women who left the workforce will increase the attractiveness of joining or rejoining the company. Being proactive with returner bonuses for women can also help address gender imbalances.

**Benefits.** Benefits can also have important implications for attracting workers. Some benefits help attract targeted groups. For example, younger workers prefer...
wellness facilities, social activities and fair and non-prejudicial maternity and paternity leaves (Oil and Gas UK Next Generation Task Group 2009). Women are particularly attracted to flexible work hours, flexible career ladders and family-friendly benefits. The benefits of contractors and rotators tend to differ from those of permanent employees. Contractors tend to have fewer benefits, while the opposite is true for rotators. Rotator benefits packages continue to expand because demand for rotators is growing while the talent pool is not.

CONCLUSION

This article has shown how the oil and gas industry’s notable differences from other industries can impact strategic decisions related to performance management and total rewards, using as examples the importance of health and safety and the unique characteristics of the oil and gas workforce. However, the same could be done for other notable differences, including the level of government involvement, the prevalence of projects and price unpredictability. These examples from the oil and gas industry show how industry factors can substantially affect strategic rewards decisions. Although the article focused on the oil and gas industry, every industry has some differentiating characteristics that should be considered by total rewards professionals when formulating and implementing rewards strategies.

AUTHOR

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REFERENCES


Is Black-Scholes Always the Right Option?

After years of falling out of favor — due to both the financial crisis and proxy advisers considering them non-performance based — companies are once again considering the use of stock options to motivate and reward their executives and employees. Stock options are one of the best long-term incentives to encourage growth and create a longer-term orientation to executive compensation programs. Stock options also fill a hole in contemporary long-term incentive designs and can be effective in creating additional alignment with shareholders. However, stock option values can be volatile, and companies need to be thoughtful about how awards are calibrated.

In most contexts, the Black-Scholes model, which is the most common model used to determine the fair price or theoretical value of a stock option for accounting purposes, appears to work well for determining how many stock options to award to individual recipients as part of an incentive compensation package. Using the Black-Scholes value also makes sense on the surface: The value of the options is aligned with the accounting cost and the option awards can be calibrated on an
apples-to-apples basis across companies. Indeed, the majority of compensation surveys rely on Black-Scholes to value options and nearly all publicly traded companies use the model to report the value of equity that they are granting to their senior executives. What's not to like?

**POTENTIAL ISSUES WITH THE BLACK-SCHOLES MODEL**

The potential issue with using the Black-Scholes model is that the range of outcomes can be extremely broad. For example, among the companies in the S&P 100 that grant stock options, the multiple of options to full-value shares needed to deliver the same target value ranges from almost 2:1 to more than 10:1 — and this is among a sample of just 51 companies. (See Figure 1.)

So why does this range of outcomes matter? As a practical matter, the greater the ratio between full-value shares and stock options, the greater the equity plan’s leverage to the share price. In other words, executives at different companies will have different levels of rewards for the same level of performance. As shown in Figure 2, an executive at a company with a 3:1 ratio and an executive at a company with a 10:1 ratio can experience more than a $1 million difference in realizable value for the same grant value and same level of company performance over a five-year period.

These are big differences in the actual value realized from the same original accounting grant value and the same performance.

**DRIVERS OF BLACK-SCHOLES**

The key questions are: 1) Why do companies have such different Black-Scholes values and 2) Are these differences appropriate? The answer to these questions

---

**FIGURE 1 S&P 100 Stock Option to Full-Value Share Conversion**

<table>
<thead>
<tr>
<th>Percentage of Companies (n=51)</th>
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<tbody>
<tr>
<td>Number of Options Granted for Each Full-Value Share</td>
</tr>
<tr>
<td>&lt;2</td>
</tr>
<tr>
<td>2-3</td>
</tr>
<tr>
<td>3-4</td>
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<td>&gt;10</td>
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Source: Semler Brossy Consulting Group
depends on the driver(s) of the disparity. Table 1 shows a number of key factors that drive the Black-Scholes model.

Some of these inputs are unlikely to be very different between companies. For example, nearly all companies grant stock options with an exercise price equal to the market price on the date of grant (and it is the ratio between these inputs that drives the Black-Scholes ratio). And the “risk-free rate” is generally directly linked to the interest rate on U.S. government bonds, which will be effectively the same across companies.

However, other inputs will differ across companies, and these differences have a real economic impact on the value of the options. For example, if a company has

| Exercise price relative to grant price | Requires price growth before value can be realized |
| Volatility | Broader distribution of potential stock price returns |
| Dividend yield | Option holders do not participate in dividends |
| Expected term/holding period | More time to realize potential stock price growth |
| Risk-free rate | Higher opportunity cost |
a large dividend yield, the options will be worth less because option holders do not participate in dividend distributions until the options are exercised. This has a real and potentially material impact on the participant’s expected return. Likewise, a longer option term gives the participant even more time to realize the benefit of the option and future share price growth, which increases the value of the options.

On the other hand, if the difference is caused by the volatility assumption, it is not readily apparent that there is an economic difference that should affect the pay-for-performance relationships among different companies. Volatility is a measure of the degree of expected variance in share price returns over time — in other words, how much the stock price is expected to swing up or down from day to day. High-volatility companies will have higher highs and lower lows than lower-volatility companies. So why should a company with high volatility have a higher Black-Scholes value?

To understand this impact, one needs to conceptually comprehend how the Black-Scholes model works. The model is predicated on the belief that the stock market returns over time will follow a normal distribution. A higher-volatility company will have a broader distribution of returns (a flatter, wider curve), while a lower-volatility company will have a narrower distribution of returns (a narrower, higher curve). This relationship is illustrated in Figure 3.

Since stock options only value the positive appreciation of the stock and ignore any decreases in the stock price below the original exercise price, high volatility stocks will have more, larger positive observations than lower volatility stocks,
while the correspondingly larger negative returns of high-volatility stocks don’t count for the purposes of Black-Scholes.

Volatility in Practice
Across a wide range of companies, the relationship between volatility and stock price returns works out as expected under the Black-Scholes model. Figure 4 illustrates this relationship for the S&P 500 for the past five rolling three-year cycles (most recent cycle ending Dec. 31, 2016). The resulting plot is a fairly close approximation of a normal distribution. Higher-volatility stocks do have greater positive stock price returns than lower-volatility stocks, on average. They also have bigger negatives — but those don’t count in measuring the value of options.

When considered across industries, this result also has a strong economic logic. High-volatility companies tend to be in high-growth, very competitive industries such as technology — where the opportunities to create real value for shareholders are high, but so are the risks. Lower-volatility companies are in more stable and lower-growth industries, such as many manufacturing or consumer products businesses. Here, the opportunities to create shareholder value certainly still exist, but at a much lower level than a tech company. So options should be worth more in a tech company than in an industrial company.

However, this relationship starts to break down when looking at a smaller group of companies or even within companies in a single industry. For example, in the Global Industry Classification Standard’s (GICS) “Consumer Discretionary” companies, there is no discernable relationship between volatility and stock price returns (S&P 2016). (See Figure 6.)

**FIGURE 4** S&P 500 Stock Price Return vs. Volatility (Past Five Rolling Three-Year Periods)

Source: Semler Brossy Consulting Group
Why Does All This Matter?

These differences in volatility can have a material impact on the value of stock options as determined by Black-Scholes, and the relative differences in grant levels are further exacerbated at lower volatility levels. When the volatility input is more than 30%, a 1% change in the assumption results in less than a 4% change in the number of stock options awarded. When the volatility assumption is less than 20%, a 1% change in the assumption can change the number of options granted by 7% or more. This is a fairly large swing in the number of options granted for relatively small changes in the inputs, especially when it is not clear the assumption has a material impact on the long-term wealth creation opportunity for the participant.
When setting pay, companies generally do not benchmark pay levels against the entire market or across industries — where differences in volatility represent a real difference in the economic opportunities for managers to create value for their shareholders. Instead, companies use a subset of companies — either through general industry survey data or a defined peer group (competitive market) generally within their own or similar industries. Pay levels are then determined based on an assessment of pay and performance expectations relative to the competitive market. When stock options are used, companies then generally take the target grant value and determine the number of stock options to grant using the Black-Scholes values.

If companies use this approach and there are material differences in the Black-Scholes values, there may be a significant disconnect in the level of pay delivered to employees relative to the competitive market, even for the same level of target pay and stock-price performance. Further, if these differences are driven mostly by the volatility assumption, then these big differences in Black-Scholes may not reflect any real underlying economic differences between companies. Does one company truly have less opportunity to create value for shareholders than another company in the same industry just because their historical stock price volatility has been lower? Probably not. But the executives of this company could end up being paid much more — for the same performance — just because of this somewhat arbitrary input into the Black-Scholes model. In the earlier example, the difference was greater than $1 million for the same level of performance, simply due to differences in starting Black-Scholes values.

Note that the other most common valuation model for stock options (the binomial model) suffers from many of the same issues — volatility continues to be a major input, so one cannot avoid these problems by changing models.
What Can Companies Do?

When a company's Black-Scholes value materially differs from the Black-Scholes values at competitor businesses, the authors recommend that the company step back to understand why the differences exist. Companies should understand if the differences are driven by real economic drivers or by arbitrary accounting assumptions that may not meaningfully reflect the economic realities of the company's business or industry dynamics. If the former, the calibration mechanism is probably appropriate and no further action is needed. If the latter, companies need to determine what to do. Often an adjustment from a pure Black-Scholes calculation could be appropriate.

Specific alternatives include:

- Continuing to use Black-Scholes. Even if there is a potential disconnect, companies may want to stay the course and use the predominant practice.
- Switching to a peer-based assumption. Companies can plug in a peer-based assumption (e.g., median volatility) in order to limit distortions relative to market. This allows for the real economic drivers of stock options — term and dividend yield — to drive the relative differences in Black-Scholes values.
- Adding a floor and/or ceiling. Companies can allow the Black-Scholes value to fluctuate while identifying specific levels above or below which the ratio cannot go.
- Switching to a fixed ratio. Companies can move away from assumptions altogether and instead create a fixed ratio (e.g., 5:1) that is used to calibrate awards each year.

The Coca-Cola Co. is an example of a business using a floor and ceiling approach. The following was disclosed in its most recent proxy statement:

When determining the number of stock options awarded, a Black-Scholes value is first calculated and, beginning in 2015 and continuing in 2016, a floor and ceiling are applied based on a 30-day average stock price. This stock option “guardrail” increases predictability, helps manage the burn-rate commitment and is intended to mitigate against excessively high and low Black-Scholes values. For stock option grants in 2016, the low end of our guardrail was used, which valued options at 20% of the 30-day average stock price. This resulted in fewer stock options actually being granted than the pure Black-Scholes model would have suggested (Coca-Cola 2017).

Another example of a business that uses a fixed ratio is the Monsanto Co. The following was disclosed in its most recent proxy statement:

60% (of the target LTI value) was converted to a number of stock options by dividing the dollar amount by the estimated Black-Scholes value of our stock on the Oct. 26, 2015, grant date (estimated at 40% of the fair market value of a share of the stock on the grant date consistent with long-standing practice) (Monsanto 2016).

Note that using any calibration methodology other than the calculated Black-Scholes value will create a disconnect between the target value and the actual grant date fair value that a company is required to report. This means that a company's actual accounting expense will be higher or lower than intended.
For the named executive officers (NEOs), this approach has implications for the numbers reported in the proxy statement and the associated compensation discussion and analysis (CD&A) text. Continuing with the Monsanto example, the target stock option value as described in the CD&A is about 75% more than the value disclosed in the Grants of Plan Based Awards Table because a fixed or estimated Black-Scholes was used to calibrate the award, instead of the actual value. While a change to the calibration mechanism may be appropriate, it is important that the implications of such a change are fully vetted and understood before any decision is made.

SUMMARY
Stock options can be an effective tool to align executives with shareholders over the long term, if calibrated properly. When a company has a materially different Black-Scholes value from the competitive market, it is important to understand what is driving the differences to ensure this disconnect is appropriate. In most cases, using Black-Scholes to calibrate awards remains a reasonable approach, but at the extremes, Black-Scholes may not always be the right option.

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For all the geopolitical disruption of today’s world, mergers and acquisitions (M&As) are alive and well, despite some noticeable shifts in the landscape.

Although global M&A volume is down 4% from 2016, the first half of 2017 saw deal value up 2% (Thomson Reuters 2017). Among the more significant trends, while the value of China’s outbound transactions has dropped by 49%, the value of overall cross-border deals has increased by 9%. And despite activist investors targeting and disrupting companies in North America, Europe and Japan, private-equity fundraising has reached record highs, and the global average for earnings before interest, tax, depreciation and amortization (EBITDA) multiples upon exit is at a record-high 15.3 times.

Consistent with Mercer’s 2016 research (Cox and Passin 2017), buyers continue to take greater risks — operating with far less information, investing in new geographies and deploying unprecedented levels of capital to leverage cheap debt and credit.

In taking a broad view of business and industry around the world, it is apparent that one common denominator
is driving deal value: people. And in Mercer’s experience advising on more than 1,200 deals annually, clear evidence emerges that buyers who consistently drive exceptional operating results have a disciplined process for identifying, engaging and motivating key talent. Cox and Passin’s research (2017) underscores this.

In researching the people aspects of M&As to learn about emerging trends through the lens of deal experts, the authors shared insights that highlighted people-related transaction risks and introduced practical strategies and solutions to deliver economic value.

Still, both the buyers and the sellers polled needed precise data and a process to help them identify and retain key talent during transactions. The research pinpoints specific actions that both buyers and sellers in an M&A transaction can take to hedge flight risk, engage critical talent and drive an affordable retention plan.

**PRIMARY PEOPLE PRACTICES**

In today’s environment, capital is abundant and cheap, but the opposite is true for talent. Buyers in most transactions are vulnerable to the flight risk of key talent, and top performers are expensive to replace. The organizational change involved in most deals puts people on edge. Without an added incentive to stay focused, they may opt out or simply disengage. Successful acquirers around the world routinely manage their people assets with the same rigor and discipline they apply to managing balance sheet risk. They drive value by concentrating on three primary people practices:

- **Engage the workforce.** Skilled buyers commit to an investment in change-management communications. This starts with defining a tangible culture, assigning decision-making rights, managing risk and establishing governance and accountability.

- **Practice event management.** In auspicious M&A transactions, retention programs are viewed as insurance policies to hedge against the flight risk of top talent. By applying the right framework, buyers and sellers can effectively lock down critical talent and drive operational excellence post-close.

- **Align rewards with behaviors.** Aligning a full package of rewards — annual cash compensation, long-term incentives, benefits, etc. — is foundational to driving behaviors within the organization that will unlock true value.

The research also uncovered some important insights that paint a different picture from the last time the authors looked at M&A retention in 2012.

One significant finding: Successful acquirers are taking a people-first, bottom-up approach to retention programs. Rather than first budgeting for retention and then distributing to employees — the typical top-down process — they’re focusing on talent first and designing retention efforts around key employees.

This bottom-up approach revealed another significant trend: Retention programs are expanding outside of the C-suite. (See Figure 2.) In fact, when asked about extending retention bonus eligibility outside of senior management, 70% of buyers...
listed “other employees critical for integration.” Furthermore, 35% listed “other employees regardless of whether critical for integration” — up 150% since Mercer’s related research report was published in 2012.

Indeed, the most successful acquirers have become adept at segmenting the workforce, examining the employee population, identifying the most important people and designing the retention plan from there — how much to budget, how much to pay each individual and how much to pay over a particular period of time. Equally important in their approach is an assessment of how the new retention plan links to any existing short- or long-term retention plan.

Retention efforts during the M&A process are not without risks. First and foremost is overspending. Companies that fail to carefully evaluate the workforce and devise the right retention plan may pay significantly more than necessary when they could have retained the essential talent for a fraction of the cost. The second risk is myopia — not looking past senior management. In some companies, such as R&D-driven enterprises, the indispensable employees are not the senior managers; they are the scientists and innovators.

While sellers can often be helpful in identifying crucial talent, buyers should be wary. In one case, the seller recommended retaining the entire 200-person staff, insisting on the idea of interconnectedness: This person is necessary to this person, who is necessary to this person, and so on.

**LOCATION INFLUENCES RETENTION**

In addition, the “where” matters. Mercer’s look at global M&A trends revealed that a company’s headquarters location and industry can greatly influence talent retention practices. By understanding and taking into account these nuances, savvy buyers not only avoid talent flight, but also ensure the right level of expenditure. Certain industries pay out financial incentives that vary greatly from the norm. For example, in the technology sector, buyers around the globe fund individual
retention bonuses for all levels at an average 49% above the market median. Figure 3 shows a great deal of variation in business culture according to geography:

**United States.** Foreign buyers often feel they must overspend on talent retention in order to compete against domestic acquirers, especially if the domestic rival is publicly listed and can offer equity as part of the program. This perspective is supported by the fact that retention bonuses and payouts in the United States typically are the most generous in the world, no matter where the acquirer is located. This approach is second in the world in prevalence (76%), behind only Japan.

**Canada.** Buyers often feel that the talent retention program in the United States should cover all of North America; this is a mistake. Canadian payouts tend to be much more modest. Therefore, a distinct Canadian program should be developed that relies on local benchmarks and talent assessments. Prevalence of key rewards is common, but still much lower (63%) than in the United States.

**UK & Europe.** European buyers are slightly less inclined than American buyers to offer financial incentives (67%). Among European buyers, 41% offer retention bonuses to employees outside of senior management who are critical to the company’s long-term success — specifically those with valuable client or supplier relationships or with knowledge about essential IT systems.

![FIGURE 2 Eligibility for Retention Bonuses Globally](image)

![FIGURE 3 Eligibility for Retention Bonuses by Region](image)
Asia. Across Asia, buyers see financial incentives as imperative, particularly for deals outbound from their home markets (94%). A good example is Japan, where 89% of buyers report offering retention programs — the highest single-market prevalence level reported. Acutely aware of the shortage of management skills outside their domestic market, Japanese buyers also tend to retain local management in overseas acquisitions for at least one to three years. This singular focus on the importance of senior management, however, can obscure the long-term retention goal of identifying and developing future leaders.

Successful buyers have elevated their retention strategies from an art to a repeatable science. The results are tangible and clear — increased productivity and engagement, owner-like behaviors from retained employees and accountability throughout the organization. As M&A activity continues its global race toward value, thriving organizations cannot risk ignoring the right strategies for talent retention.

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Executive Compensation: Midmarket Companies Are ‘Fast Followers’ of Large Companies

Midmarket companies are catching up to large companies when it comes to executive compensation levels and design. Over the past six years, executive pay levels in the United States have continued to grow, reinforcing the enduring role of compensation as motivation for executive retention and performance. Although large companies continue to pay significantly more than midmarket companies, a comparatively higher level of pay growth among the midmarket over this period reflects a catch-up process taking place. What’s more, the structure of executive compensation plans among many midmarket companies has started to mirror that of top performing companies, particularly with regard to the design of short- and long-term incentive plans.

HOW COMPANY SIZE AFFECTS PAY LEVELS

To aid in the discussion of midmarket companies in comparison to larger companies such as S&P 500 and Top-200 companies, the article defines the size of each group in Table 1, showing the revenue range from the 25th percentile to 75th percentile, and the median.
Recently, Arthur J. Gallagher & Co. completed research to better understand the differences that exist in executive compensation levels between the top-performing S&P 500 index and the broader Russell 3000 universe. The study included companies that filed annual proxy statements from Jan. 1 through May 30, 2017. That encompassed 429 companies of the S&P 500 and 2,418 companies of the Russell 3000. These filings detailed compensation plans and programs for fiscal year 2016.

For purposes of comparison, the Russell 3000 represents a typical mid-market company with a median revenue of about $850 million. With a median revenue of about $12.5 billion, the S&P 500 subset represents a large company.

The research showed that median total compensation for the CEO of an S&P 500 company was $11.5 million in 2016, while the Russell 3000 counterpart earned about one-third of that amount — $3.8 million. However, median total compensation for the Russell 3000 was 54.8% higher than in 2010.

This increase is nearly double that seen in the S&P 500, where CEO pay levels grew by only 27.7% during the same seven-year period. (See Figure 1.)

### TABLE 1 Parameters of Midmarket, Large and Very Large Companies

<table>
<thead>
<tr>
<th>Group</th>
<th>Revenue Range (2016 data)</th>
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| **Midmarket:** Russell 3000 universe (2,418 companies) | Range: $200M to $3B  
Median: $850M |
| **Large:** S&P 500 subset (429 companies) | Range: $4B to $20B  
Median: $12.5B |
| **Very Large:** Top-200 subset (200 companies) | Range: $13B to $80B  
Median: $22B |

### FIGURE 1 Median CEO Total Compensation Increase 2010-2016: Russell 3000 vs. S&P 500

Source: Arthur J. Gallagher & Co.
Company size has always affected CEO pay levels and will continue to do so, but accelerated growth in the midmarket shows that attention is being paid to what larger competitors are doing in an increasingly homogenous executive talent pool. From a compensation value perspective, executive pay at midmarket companies will never reach the levels seen at larger companies.

**INCENTIVE PLAN DESIGN AT MIDMARKET VS. VERY LARGE COMPANIES**

The findings showed that performance-based awards now approach 50% of the total long-term incentive (LTI) award value among midmarket companies, demonstrating that these companies adopt the LTI trends of the country’s largest companies, but with some lag time.

The more overwhelming evidence of midmarket companies adopting the compensation approaches of larger companies is uncovered upon taking a closer look at incentive plan design. In conjunction with the review of Russell 3000 versus S&P 500 companies, Gallagher looked at how a smaller sample of midmarket companies structured both short- and long-term incentive plan design in the three-year period from 2014 through 2016. This 100-company sample (“Mid-Market 100”) was selected at random from the Russell 3000 universe and included companies across multiple industry sectors. The Mid-Market 100 incentive program characteristics, including use of stock options, time-based restricted stock and performance-based programs, were then compared with the same data collected from the large industry leaders that make up Top-200 S&P 500 companies based on market cap (“Top 200”) over the period from 2008 through 2015.

Among the Top-200 companies by market capitalization, performance-based LTI awards averaged 50% of LTI grant value back in 2012, reflecting at that time a greater desire among large companies for pay-for-performance alignment and rewards with a big potential upside within the limit of 162(m) tax-deductibility. That said, the midmarket is catching up, with performance-based awards making up 48% of the total LTI grant value in 2016, up from 39% in 2014. Following the trend of large companies, as performance-based awards have increased in the midmarket, both appreciation awards and time-based restricted stock/units have declined (from 26% and 35% in 2014 to 20% and 32% in 2016, respectively).

The 9% increase in performance share usage among midmarket companies (from 39% to 48%) over the three-year period from 2014 through 2016 shows that changes in midmarket compensation plans happen rapidly once initiated; roughly the same 9% increase (from 41% to 50%) took five years at Top 200 companies. (See Figure 2.)

The study also found that regardless of size, companies typically use similar measures for their incentive design (both short and long term).
EXPLAINING THE TRENDS

This midmarket momentum toward top company trends is the result of such factors as:

1. Higher Risk Reward Profile Typically Means Higher CEO Pay

The increase in the use of performance-based awards can also be attributed to the fact that CEOs have come to view them positively. First, pay for performance is well received by the board, shareholders and proxy advisers alike. Second, and more importantly, CEOs are beginning to realize that they can actually earn more because most performance-based LTI plans will pay out more than other plan types if target performance is exceeded. This is mutually beneficial for the company and executive.

2. More Active Investor Oversight: The Onset of Say-on-Pay Vote and Shareholder Outreach

It is common for companies large and small to engage their shareholders and ask what they can do to improve their executive compensation programs. This
outreach, combined with the annual say-on-pay scorecard, pushes all companies toward performance-based incentive plans.

Say on pay is now a fundamental part in decision making of compensation committees (facilitated by compensation consultants) as the standards of proxy advisers such as Institutional Shareholder Services (ISS) and Glass, Lewis & Co. LLC continue to evolve. Indeed, with say-on-pay voting an annual event for most companies, pay for performance has become a core issue for all public companies, regardless of size. Improving the disclosure of performance measures used, the values associated with those measures, and how they expect to drive performance has been of the utmost importance to avoid unwanted scrutiny.

A faulty incentive design could lead to a failed vote, which in turn may expose an executive and the board of directors to criticism from investors, media and the general public. ISS continues to have strong influence over SOP results because an ISS vote recommendation “for” say on pay practically assures significant majority shareholder support. An “against” say-on-pay vote recommendation from ISS most often results from a poor pay-versus-performance relationship. ISS bases its recommendation on three quantitative tests and a thorough qualitative review of various factors relating to performance-based pay, such as the ratio of performance-based compensation to total compensation, the ratio of performance-based equity to time-based equity, financial and operational performance, realizable pay, and the completeness of disclosure and rigor of performance goals.

3. The Use of Compensation Committee Advisers
Advisers act as messengers of best practice, customizing knowledge gained working with larger companies to fit the needs of smaller companies. Almost all compensation committees engage outside advisers such as consultants and lawyers on matters related to executive compensation. These advisers are expected to be experts in the appropriate level and structure of annual executive pay programs, helping companies stay informed of trends in the area of executive compensation and assisting with the development of compensation programs for the CEO and other top executives. The top executive compensation consulting firms and law firms hold most of the market share for board engagement within the Russell 3000. Accordingly, an adviser working for a larger company in the Russell 3000 could very likely be engaged by a midsized company in the Russell 3000. This is particularly feasible if the companies are in the same sector, as many boards appreciate industry-specific experience when selecting their advisers. The work performed by advisers for a board could range from a high-level review of plans already in place to a complete redesign of incentive plan structure.

Typically, larger companies have a budget that allows for the total overhaul of incentive design structure to better align pay with performance. This is where compensation advisers can really flex their creative muscle and create original plan concepts that, if effective, may become a new best practice. A midmarket
company that engages that same adviser down the line might be interested in a new plan, but cannot pay for the same level of engagement and creativity. Instead, the middle-sized company might ask for a general review of their incentive plan, identification of disconnects and some high-level recommendations. The adviser firm will undoubtedly draw on the effectiveness of the plan it labored over for its larger client when thinking through the appropriate action for the midmarket client.

4. A Board of Director Pool That Is Size-Blind

The director talent pool spans across all company sizes and industry sectors. It is not uncommon for the director of a top-performing company to hold a board seat at a midmarket company, or even a small company. These directors are armed with the knowledge of compensation plan structures that work for the top performers they govern, and will understand the value of these arrangements when helping make compensation decisions for executives of other companies they oversee. This is similar to the process outlined earlier with compensation consultants, and even overlaps as independent board members work closely with the compensation consultant.

There are still a large number of CEOs who sit on other boards. These CEOs (as well as other senior executives such as CFOs) bring the knowledge gained from their experiences to the other board members as well as compensation committee advisers.

CONCLUSION

The trends in executive compensation indicate that most public companies, regardless of size, have redesigned their incentive programs during the past several years to ensure there is a link between performance achievement for the company and executive, and performance achievement for shareholders. Indeed, the study confirms continued increases in the use of performance-vested grants as a means for more closely linking pay to performance. Pay trends that start with large, top-performing companies are trickling down to the midmarket.

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Global Trends in Pay: The Old Normal?

When looking at global salary trends last year, Willis Towers Watson asked a challenging question: In a consistent low-inflation environment, does inflation still act as the key driver for salary increases? At the time, the conclusion was that inflation and salary budget planning had, to a certain extent, decoupled. Is it now time for a renewal of vows?

THE WORLD AT A GLANCE

Many economists and financial institutions are finally seeing the signs of a stable and generalized recovery. According to the International Monetary Fund (IMF) World Economic Outlook (2017), investments, manufacturing and trade are gathering momentum. World growth is expected to rise from 3.1% in 2016 to 3.5% in 2017 and 3.6% in 2018. Core and noncore consumer price index (CPI) inflation are forecasted to once again rise in both advanced and emerging markets. (See Figure 1.)

This positive macroeconomic outlook is also shared by the European Central Bank (2017), whose latest findings report an economic recovery in the Euro area that is projected to continue at a faster pace than previously
expected. Both gross domestic product (GDP) and inflation indexes are forecasted to grow over time. The expected global recovery will support exports, while the very accommodative monetary policy and structural reforms across the European Union’s 27 members (EU27) will sustain domestic demand in the medium term.

Thus, it seems that the glooming days of the global recession have ended and the world can finally take a breath. But how will this affect salaries? Are organizations ready for this surge in inflation?

Companies cannot typically afford to deliver significant pay increases to all employees each year. With employees expecting an annual increase regardless of their job marketability, employers are already struggling to effectively differentiate pay based on talent segment or performance. Increasing inflation rates make this issue ever more acute. The more pay budget taken up in ensuring employees do not see a real-terms decrease in pay, the less is available to reward individual performance, critical skills or key talent.

**Europe, Middle East and Africa (EMEA)**

When looking at the EMEA region as a whole, salaries have seen the lowest increases since 2010. Willis Towers Watson (2017) reported in its latest “Global Salary Budget Planning Survey” an overall increase of 4.5% against an increase of 4.8% in 2016. Companies seem to have tightened their belts an extra notch, leveraging the prolonged low-inflation scene. But in the meantime, the unexpected surge in inflation has swiftly changed the background. With a 5% inflation rate in 2017, the highest since 2010 and 0.9% above 2016, many employees in EMEA will see about a 0.5% reduction in real-term purchasing power.

This trend seems to be replicated across the different subregions. In Africa, 2017 real wages are in negative territory: -3.2% compared to -2.2% in 2016. Angola, Democratic Republic of Congo, Egypt, Malawi, Mozambique and Nigeria are the
countries to watch closely with salaries eroded by an average of -11.3% due to the spike in inflation.

In Eastern Europe, real wages are forecast to remain substantially flat (+0.1%) against +1.4% in 2016. Despite a fairly balanced overall picture, employees in Uzbekistan (-11.2%), Azerbaijan (-4.2%), Moldova (-2.4%) and Turkey (-1.7%) will be the most impacted and likewise see a decrease in purchasing power.

In contrast, employees in the Middle East will still see their salaries increase against inflation by 1.3%. The figures show that this will be the lowest real-term increase since 2010 and rather far from the +4% seen in 2015.

In Western Europe, employees have fared comparatively well versus the wider region up until now. From 2012 onward, workers have enjoyed real-term increases due to a prolonged period of low inflation paired with private-sector salary increases of 2.4% in both 2016 and 2017. However, it looks likely that this trend will reverse with inflation now climbing and set to outstrip salary increases in the coming years, which will put increasing pressure on purchasing power. It should be noted that behind such broad trends, the picture seems to be different depending on the various markets. For example, Irish, Cypriot, Danish and German employees will still see their real-terms wages increase by more than 1% this year, while Spanish and British colleagues will see salary increases eroded by a recent surge in the cost of living.

North America
Employers in the United States and Canada have historically remained cautious about budgeting pay increases. Gross numbers haven’t substantially moved for the past five years and the 2017 median figures do not constitute an exception to this trend. Despite a rise in inflation of 0.7% in Canada and 1.2% in the United
States, organizations continue to confirm essentially the same 3% overall increase they have allocated since 2013. However, employers continue to reward their best performers with significantly larger pay raises as they struggle to retain top-performing talent in a tightening labor market. This trend seems to be reinforced by a prolonged and generalized increase in merit budgets, displaying a clear effort to segment the workforce population and reward more critical skills and key talent.

Asia Pacific
With gross salary increases at 5.9% across the region, 2017 is the third consecutive year of salary increase budgets declining across the region. Organizations seem to continue to walk down the path of reducing costs in response to a broader economic environment in which Asia Pacific’s contribution to the world economy is forecast to shrink, as both the Chinese and Indian economies experience slower-paced growth than in previous years.

Focusing on salary trends, this region as a whole is experiencing a drop in salary increases in eight out of 21 Asian countries, with the other 13 remaining substantially flat. Among these, employees in China and India will see their real-terms wages rise by 4.7% and 5.6% respectively, not hugely out of line with the 4.9% and 5.1% of 2016. However, organizations in all Asian markets are forecast to spend a higher proportion of their salary budgets on top performers as the salary increase allocation for overachieving employees will increase from 37.6% in 2016 to 38.2% in 2017. There is no doubt that the war for highly skilled talent continues to challenge organizations even in this region. Many companies are expected to bet on the power of cash to help dissuade their human assets from leaving. After all, pay remains the No. 1 driver for attraction and retention across the world, and Asia Pacific is no exception.

Latin America
In line with Europe, Middle East and Africa and Asia Pacific, Latin American salaries (excluding Venezuela) have seen the lowest increases in seven years. With a reported overall salary increase of 5.8%, the 2017 gross budgets will be the lowest since 2010. Despite this, 2017 real-terms salaries will be higher than in 2011, 2014 and 2016, mostly due to inflation decreasing in the region. Employees in Argentina, Colombia, Brazil and Uruguay will see their cost of living alleviated by lower inflation, whereas their counterparts in Mexico will see their purchasing power reduced by a surge in the opposite direction.

In Venezuela, inflation has gone up from 104.1% in 2015 to 652.1% in 2017, and workers have not benefited from real-terms increases since 2012. There are elements that fall outside what organizations can predict. Although companies can try to protect their workforce, the space of action is limited when inflation is forecasted to pass the 2,000% mark and political stability is uncertain. HR professionals will never be able to control the macroeconomic factors that affect salaries,
but they can learn how to react in an increasingly changing world. Venezuela, and
to some extent Argentina, remind us that one size doesn’t fit all and that budgeting
differentiation, both from a talent and geographical perspective, remains a key
competitive advantage for local and global companies.

CONCLUSIONS

Economic forces have produced a post-economic-crisis world in which low-infla-
tion scenarios are considered the norm. The first half of the 2010s has shown that
gross budgets don’t necessarily react to year-on-year inflationary movements unless
acute (Latin America). Some markets (predominantly more established markets in
Western Europe, North America and Asia Pacific) have highlighted that employers
now treat salary budgeting and inflation as two separate matters and that the
cause-and-effect relationship between wages and inflation has lost its power or
relevance. Companies are instead starting to focus on providing meaningful perfor-
man ce-based or promotion increases, focusing more on greater differentiation,
with the upshot being more poignant consideration of zero increases elsewhere.

Will the new surge in inflation levels change this modus operandi? We will find
out. However, no matter the economy, companies will always need to react to
inflationary pressures to protect their workforces. If periods of low inflation have
presented an opportunity to rethink the salary budgeting strategy and segment
employees, granting more to top performers and key talent and less to the rest
of the staff, how will organizations allocate a fair share to all now, and at the
same time, adequately reward overachievers and their talents? Will employers
increase their overall salary budgets or focus even more on highly valued jobs
and employees? Might the concept of an annual pay review for all need its own
review? Perhaps some talent segments might need more regular reviews while
others might be more career-milestone-based and receive increases less often?
The cost of living may well not act as the key driver for salary budgeting in many
markets anymore, but a link between salary increases and inflation is still there.
They may continue to be decoupled, but will always dance together.

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Labor-Related Regulations Take a Financial Toll
More than half of HR and payroll professionals (54%) say that, on average, it costs their organization between $40,000 and $100,000 to prepare for each labor-related regulatory change, regardless of whether that’s at the federal, state or local level.

The Workforce Institute at Kronos Inc. published the report “The $100,000 Bill” based on a national survey of 812 HR and payroll professionals in management, senior leadership and the C-suite.

The costs cited by employers cover a range of activities that vary by organization. Those include:

- Consulting with legal counsel to create new internal policies
- Training for HR and payroll employees
- Educating leaders and managers on the change
- Wide-ranging employee communications to ensure everyone understands the change.

Respondents expect the cost of compliance to keep going up, too. 68% said compliance has become more expensive in the past year, while three-quarters (74%) said it’s more expensive than in 2007. And while larger organizations are more sophisticated at tracking expenses related to maintaining compliance, one out of every five organizations with fewer than 500 employees (20%) surveyed aren’t sure how much the activity of remaining compliant costs annually.

There are more implications beyond the financials for employers trying to keep pace with changing regulations. While regulatory changes can become law in as little as 60 to 90 days, 53% of respondents said more time is needed to create and communicate new internal policies to employees. 40% of HR and payroll professionals said 120 to 150 days is the preferred amount of prep time, and 24% of respondents at smaller organizations said they require a minimum of 150 days. With too much work and not enough help, 58% of respondents reported they’ve witnessed colleagues occasionally cut compliance-related corners.

Workers Are More Secure, Satisfied in Their Jobs
Job satisfaction rates improved for the sixth year in a row and, for the first time since 2005, job satisfaction surpassed the 50% mark — meaning more than half of U.S. workers surveyed are satisfied with their jobs.

Why are employees feeling so positive? The increase in job satisfaction is largely due to the improvement in the labor market in recent years, according to findings of “The Conference Board Job Satisfaction” survey, an annual barometer of satisfaction of the U.S. worker.

The Conference Board predicts several trends will continue moderating satisfaction levels: the emphasis on maximizing shareholder value, declining unionization, outsourcing (both domestic and foreign) and market concentration.

Along with overall job satisfaction, the report looked at 23 components that contribute to job satisfaction, including wages, job security and health plans. The report found that workers are more satisfied with:

- People at work (60.5%)
- Their commute (59.2%)
- Interest in work (58.4%)
- Their supervisor (57.3%)
- The physical work environment (56.1%).
But not everything’s coming up roses, according to the report. The five components that U.S. workers are least satisfied with are:

- Promotion policies (25.4%)
- Bonus plans (25.5%)
- Educational/job training programs (30.8%)
- The performance review process (31.2%)
- Recognition/acknowledgement (34.3%).

ExeCs Say Skills Shortage Is the No. 1 Challenge for Companies

Business executives are generally upbeat about prospects for the U.S. economy, and they have upgraded expectations for profit and revenue growth for the next 12 months. But there is one area where they’re not as optimistic: suitable job candidates.

For the first time, “availability of skilled personnel” was cited as the top challenge facing companies, per respondents to the third-quarter “AICPA Economic Outlook Survey.” In the Association of International Certified Public Accountants’ poll of CEOs, CFOs, controllers and other certified public accountants who hold executive and senior management accounting roles, 75% of respondents said they were seeing at least some increased competition in recruitment efforts. 21% of respondents said there’s been a significant increase. At the end of 2014, the last time this survey question was asked, only 16% said they were experiencing a significant increase in hiring competition.

Despite recruiting challenges, half of business executives said their companies had the right number of employees. 24% said they planned to hire immediately, the same as last quarter, while another 15% said they had too few employees but were hesitant to hire. Respondents who said their companies had too many employees dropped from 8% to 7%, quarter over quarter.

Besides “availability of skilled personnel,” the top three concerns for business are No. 2 “regulatory requirements and changes,” and No. 3 “domestic competition.” “Employee and benefits costs” dropped from the top slot last quarter to No. 5.

Remote Workers Perceived as Less Valuable

In-office employees’ perceptions about remote workers and their disconnect from company culture is becoming a cumbersome career pain point, concluded the “Reality of the Remote Workers Report” from CyberLink Corp. The study reports that remote workers understand productivity, but office workers think it’s twice as difficult for remote workers to build a relationship with the boss, make work friends, collaborate with their team and navigate the workplace culture than in-office workers. The survey queried 1,154 U.S. working adults.

Respondents cited other perceived disadvantages, including that remote workers:

- Are less valued by a company (15%)
- Don’t get to experience office culture (38%)
- Get promoted less often than in-office workers (20%)
- Are less trustworthy (8%).

While working from home may sound like an appealing way to balance work and personal life, most office workers expressed potential frustrations when asked about their concerns regarding remote work. 42% of respondents said that, as a remote worker, they wouldn’t be able to build relationships with co-workers, and 36% said they would feel lonely or isolated from their team.
Another third (34%) said they would miss out on office culture if they worked from home, demonstrating that simply being present in the office with co-workers appears to be a large factor of a positive work experience.

With the speed at which the business world is shifting in this gig economy, the move toward remote work likely will not reverse. Simplifying communication and aspects of collaboration among workers is a necessary part of making remote work successful, especially when 31% of remote workers have been late or missed a meeting because of a technological failure, Cyberlink pointed out.

The Price of Today’s Workplace Environment

Unstable work schedules, unpleasant and potentially hazardous working conditions and often-hostile social environments are adding up to an American workplace that is physically and emotionally taxing for today’s workers.

More than one in four American workers reported that they have little time to do their job, according to the “Working Conditions in the United States: Results of the 2015 American Working Conditions Survey” from RAND Corp., Harvard Medical School and UCLA. The complaint is most common among white-collar workers. Workers also reported that the intensity of work frequently spills into their personal lives, with about one-half of people reporting that they perform some work in their free time to meet workplace demands.

While eight in 10 workers reported having steady, predictable work throughout the year, 54% reported working the same number of hours on a day-to-day basis. One in three workers said they have no control over their schedule. And, despite much public attention on the growth of telework, 78% of workers reported that they must be present at their workplace during regular business hours.

Nearly three-fourths of workers reported either intense or repetitive physical exertion on the job at least a quarter of the time. While workers without a college education reported greater physical demands, many college-educated and older workers reported being affected as well.

More than half of American workers reported exposure to unpleasant and potentially hazardous working conditions. Nearly one in five said they face a hostile or threatening social environment at work. Younger and prime-aged women are the workers most likely to experience unwanted sexual attention, while younger men are more likely to experience verbal abuse.

There is a bright side, though: American workers appear to have a certain degree of autonomy on the job, most feel confident about their skill sets and many reported that they receive social support while on the job.

The findings are from a 2015 survey of 3,066 adults who participate in the RAND American Life Panel, a nationally representative, computer-based sample of people from across the United States.